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THE CENTRAL INTELLIGENCE AGENCY

SOVIET ECONOMIC PROBLEMS MULTIPLY

In the past few years, Moscow's aggressive foreign policy has been accompanied by boasts of overtaking and surpassing US production by 1970, thus in Khrushchev's words, defeating capitalism without war. However, an analytical review of recent Soviet economic performance compared with that of the US supports just the opposite conclusion -- namely, that the Soviet Union is falling behind in the economic race.

The first years of Khrushchev's leadership were marked by a series of successes. The expansion of planted acreage through the New Lands program gave agriculture its first real lift since 1937. Economic growth was rapid -- probably better than 6 percent a year for the 1950-59 period as a whole, aided by cuts in armed forces personnel and in military spending which took place in 1956 and 1957.

While housing continued to be very tight, there were noticeable improvements in living standards, particularly in foodstuffs but also in consumer goods as compared with the late Stalin years.

After 1959, however, economic growth began to slow appreciably. The rate of expansion of fixed investment, upon which growth depends, was not maintained. With annual increases in investment cut in half, falling to between 4 and 5 percent in 1962-63, a sharp curtailment in economic growth was inevitable. In 1962, Soviet gross national product was about $260 billion, or 47 percent of that of the US. Because the differences in the rate of growth have narrowed, little change in this proportion is expected over the next few years.

To a great extent Soviet economic difficulties stem from a series of programs too ambitious for available resources. With a gross national product less than half that of the US, the Soviet leadership has invested in new plant and equipment amounts nearly as large as investment in the US and has maintained a military-space program approaching in real cost that of the US.

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Much of the blame for recent reductions in the rate of growth falls on the sharp increase in Soviet defense spending, which between 1959 and 1963 increased by about one-third. However, the problem centers less on the total size of defense outlays than on the diversion of scarce, critical resources -- both manpower and materials. The military "bite" was particularly severe on the best scientific and engineering talent, on the most skilled construction specialists, and on the associated high-quality materials and components. The costs of increased military efforts showed up in shortfalls in industrial investment, especially in the chemicals industry, and in the gross underfulfillment of the Soviet plan for automation and modernization in industry.

Although the slowdown in industrial output has had its effect, the serious decline in economic growth in 1962 and 1963 is largely due to the failures in agriculture.

A necessary corollary of the headlong rush to develop heavy industry was the neglect of agriculture. Starved for investment funds, agriculture was faltering badly by the time Stalin died. Khrushchev succeeded, at very small cost, in temporarily reversing the downward trend. The New Lands put more grain into Soviet stomachs, into livestock, and into foreign markets -- perhaps most importantly from the standpoint of political stability, into the European Satellite countries to make up deficits in their own laggard farm output. But the returns from the vast new acreage plowed up in 1955-58 proved to be temporary. Once the original soil moisture and fertility were used up, output fell off. In 1963, a severe drought in the traditional farming areas, as well as in Kazakhstan and Siberia, resulted in a near disaster. Output on a per capita basis in 1963 was about 10 percent below that of 1958. Total agricultural output declined some 4 percent in 1962 and probably more than 4 percent in 1963.

The plight of Soviet agriculture is further illustrated by the composition of the Soviet diet. In total calories, the average Russian citizen is not far behind his American counterpart. But 70 percent of the Soviet diet consists of grain and potatoes, compared to 28 percent in the US. Only 25 percent of the Soviet diet consists of quality foods -- livestock products, vegetables, and fruits.

The impact of a short grain crop on this pattern of diet is obvious. Bread for human consumption must be curtailed. Livestock herds must be reduced. There is plenty of recent evidence on the disappearance of

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flour from stores, of distress slaughtering of livestock, and of the elimination of free bread from factory cafeterias.

The revolution of rising expectations applies in the Soviet Union as well as in other parts of the world and Khrushchev recognizes this is a more serious problem for his regime than it was in Stalin's day. Rising food prices, shortages of meat and bread, a decline in housing construction, and small gains in the output of consumer durables are sources of growing consumer dissatisfaction.

The Soviet leaders are now calling for a solution to the agricultural problem and for a faster increase in certain consumer goods through the expansion of the chemical and related industries. They appear determined to commit the very substantial resources required. As formally presented by Khrushchev on 9 December at the Central Committee plenum, the new program calls for tripling production of chemicals by 1970. Among the specific goals of the program are production increases in fertilizers from 20 million tons to 70 million to 80 million tons in 1970.

Khrushchev apparently recognizes that the needs of this new program will clash with those of other claimants. He has implied that the resources earmarked for the expansion of the chemical industry will come in part from the overall growth of the economy, from imports, and from the diversion of funds from communal services and housing construction. He has also noted the need to study possible reductions in the strength of the armed forces.

Although the Soviet economy, given more favorable agricultural weather, may be able to rebound from last year's growth of 2.5 percent, the prospects for recovery to a sustained growth rate equal to that of the 1950's are not bright.

In an attempt to maximize industrial investment, the Soviet Union is turning to the West for greatly expanded credits and far more liberal repayment terms than the present 5 years. Moscow's gold position today is viewed as little better than minimal, with reserves of less than $2 billion.

A chronic inability to generate enough exports to the West to cover rising imports has resulted in a continuous drain on gold balances. Soviet gold sales in 1963 amounted to $400 million to $500

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million, compared with recent annual production of about $150 million to $175 million -- production which incidentally is very high cost even by Soviet standards.

The accelerated outflow of gold in 1963-64 is a direct response to the payment requirements generated by purchasing nearly 10 million tons of grain in the Free World. The import requirements for chemical machinery and equipment, largely to produce fertilizers, will exceed several hundred million dollars a year, and could be $2 billion in total.

Hence, the current Soviet push for new foreign credits and extended repayment terms is directly related to Moscow's desire to prevent the chemical program from impinging too directly on the production of military end items. In 1962-63, new medium-term credits from the industrial West amounted to about $300 million annually. However, payments on principal and interest for past loans left only a small net balance in 1963. With the growth of traditional Russian exports slowing down or declining in virtually all major categories -- petroleum, timber, grain -- increased credits represent the only promising means of financing substantially larger imports of machinery.

While the Soviets have been seeking larger credits from the West, the cost of their own economic aid program to the less developed countries also has been steadily rising. New extensions of credit in 1963 did not exceed $200 million, compared with more than $800 million in 1959; however, drawings against Soviet credits have continued to increase, approaching $400 million in 1963 (exclusive of drawings against military credits).

In summary, the Kremlin leadership for several years has been trying to do too much with too few resources. This living on borrowed capital, improvising cheap but temporary solutions to basic problems such as agriculture, and chronically neglecting balanced development to push ahead spectacularly on a narrow range of goals has finally caught up with the Soviet Union. A nearly disastrous crop failure in 1963 was not the root cause of Moscow's current economic difficulties; what it did was to bring to a head the many underlying problems of the Soviet economy and force a reconsideration of the pattern of resource allocation.

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